

Week 1 – Teamwork

1.25 (Estimated time - 30 minutes)

Policy/ Procedure	Element (a)	Purpose of Policy / Procedure (b)	Additional Procedure (c)
1.	Personnel Management	Personnel should have the qualifications to fulfill responsibilities they may be called upon to assume in the future.	Establish qualifications necessary for each level of responsibility in the firm.
2.	Engagement Performance	Work at all levels should be supervised to assure that it meets the firm's standards of quality.	Establish procedures for reviewing working papers and reports.
3.	Personnel Management	Work is assigned to people who have the technical training for the assignment and personnel should seek assistance, when necessary, from persons having appropriate expertise, judgment, and authority	Identify areas and specialized situations for which consultation is required.
4.	Independence, Integrity and Objectivity	All professionals should be independent of clients.	Monitor compliance with independence rules.
5.	Monitoring	Determine that procedures relating to the other elements are being effectively applied.	Provide for reporting inspection results to appropriate management levels in the firm.
6.	Personnel Management	Only individuals who possess the qualities of integrity, competency, and motivation should be hired.	Maintain a recruiting program to obtain new hires at the entry level.
7.	Personnel Management	Personnel should have the knowledge required to fulfill assigned responsibilities.	Provide Programs to develop expertise in specialized areas and industries.
8.	Engagement Performance	Personnel should have the technical training and proficiency required by the engagement.	Permit partner in charge of engagement to approve assignments.

Policy/ Procedure	Element (a)	Purpose of Policy / Procedure (b)	Additional Procedure (c)
9.	Acceptance and Continuance of Clients and Engagements.	The firm should not be associated with clients whose management lacks integrity.	Establish review procedures for continuing a client.

4-26.

Part I

- a. No. Peters will not prevail. The facts do not involve liability in the sale of registered securities nor liability for reports filed with the SEC. Because the stock transaction involved interstate commerce, Peter's claim may be based on Section 17 (the antifraud provision) of the Securities Act of 1933 and Rule 10b-5 under the Securities Exchange Act of 1934. In either case, he will have to show fraud on the part of Doe, or a manipulative device or scheme, in connection with the sale of a security under the 1933 act or the purchase or sale of a security under the 1934 act. If this can be shown, an implied civil damage remedy is available to Peters against Doe. (Note - Section 17 is not discussed in the chapter.)

Although Doe was negligent, the United States Supreme Court, in the Hochfelder case, held that a violation of Rule 10b-5 requires scienter, something greater than mere negligence. Unless the violation of GAAS involves intent, or gross negligence, Doe would not be held in violation of Rule 10b-5.

Similarly, Peters might claim a remedy against Doe for violation of Section 17 of the 1933 Securities Act. The Supreme Court, in the Aaron case, held no scienter is required in certain Section 17 cases brought by the SEC, but it appears that private actions, such as the one by Peters, would be subject to provisions similar to those in Rule 10b-5.

- b. No. Peters will not prevail based upon his state common law action either. At common law, privity is required before an accountant can be held liable to users of the financial statements, absent fraud. Doe was not in privity of contract with Peters, nor does the question indicate that Doe was even aware that Peters would rely on the financial statements.

Part II

Yes. Ira will prevail and recover damages from Baker. He will base his action on Section 11 of the Securities Act of 1933. Section 11 imposes liability on experts, including accountants, whose opinions appear in a registration statement. The experts are liable to all those who in reliance on their opinions purchase securities in a public offering under the 1933 act. Ira does not have to prove Baker was negligent in auditing Able. All he need allege and prove is that there is a material false statement or omission of a material fact in the registration statement. The only defense that Baker may assert is that it exercised the degree of care that would be exercised by certified public accountants in similar circumstances. This is commonly referred to as the "due diligence" defense. Negligence by Baker is therefore a violation of Section II, and makes Baker liable to Ira for his damages.